Conversent Communications

Via Overnight Mail and Electronic Mail

August 23, 2005

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station
Boston, MA 02110

Re: Verizon Arbitration, D.T.E. 04-33

Dear Ms. Cottrell:

Conversent's Motion for Reconsideration is enclosed for filing.

Also, it has come to my attention that the Department's service list might still reflect our old address. If so, please adjust your records to reflect:

Gregory M. Kennan
Conversent Communications of Massachusetts, Inc.
24 Albion Road, Suite 230
Lincoln, RI 02865
401-834-3326 Tel.
401-834-3350 Fax
gkennan@conversent.com

In addition, please include our legal assistant, Nancy Jacobson (njacobson@conversent.com), on electronic service lists. It is not necessary to send paper copies of documents to her.

Thank you. Please contact me if you have any questions.

Very truly yours,

Gregory M Kennan

Gregory M. Kennan
Director, Regulatory Affairs and Counsel

Cc: Tina W. Chin, Arbitrator
Jesse Reyes, Arbitrator
Michael Isenberg, Director, Telecommunications Division
April Mulqueen, Assistant Director, Telecommunications Division
Paula Foley, Assistant General Counsel, Legal Division
Berhane Adhanom, Telecommunications Analyst
Ashish Shrestha, Telecommunications Analyst
Alexander W. Moore, Esq., Verizon
Service List (by electronic and first-class mail)

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Petition of Verizon New England Inc. for Arbitration of an Amendment To Interconnection Agreements with Competitive Local Exchange Carriers and Commercial Mobile Radio Service Providers in Massachusetts Pursuant to Section 252 of the Communications Act of 1934, as Amended, and the *Triennial Review Order*	**D.T.E. 04-33**

CONVERSENT'S MOTION FOR RECONSIDERATION

Introduction

Conversent Communications of Massachusetts, Inc. ("Conversent") respectfully moves for reconsideration of certain portions of the July 14, 2005 *Arbitration Order*. Specifically, Conversent moves for reconsideration of those portions of the order based on the Department's legal rationale that where a promulgated regulation of the Federal Communications Commission ("FCC") appears unambiguous, the Department will not look to the text of FCC orders interpreting the regulation. *See, e.g.,* Arbitration Order at 77.

Conversent respectfully suggests that the Department's legal rationale is incorrect, inappropriate, and, as applied in this case, counterproductive to the pro-competitive policy goals of the Telecommunications Act of 1996. In addition to rendering meaningless the FCC's interpretive text — which the FCC published purposefully and for good reason — the Department's rationale has not been followed by the courts or the FCC itself. To the contrary, both courts and the FCC have looked at the regulations and interpretive text together and read them as harmonious whole. The Department should do the same.

Background

At least two rulings in the *Arbitration Order* are based on the Department's method of interpreting FCC regulations and orders described above. First, the Department applied a cap of ten DS-1 dedicated transport circuits per route, irrespective of whether DS-3 unbundling was required on that route. *Arbitration Order* at 76-77. The Department applied the 10 DS1 cap on all routes (including routes where DS3 transport must be unbundled) notwithstanding that the FCC clearly stated in the *Triennial Review Remand Order* that the 10 DS1 cap applied only on routes where DS3 unbundling was not required. *Arbitration Order* at 77; *see In the Matter of Unbundled Access to Network Elements,* WC Docket No. 04-313, Order on Remand, FCC 04-290, ¶ 128 (Feb. 4, 2005) (*"Triennial Review Remand Order"* or *"TRRO"*).

Similarly, in determining that the unbundling relief granted to fiber to the home (FTTH) and fiber to the curb (FTTC) loops was not limited to mass-market customers, the Department relied only on the text of FCC regulations and not on an extensive explanation contained in the interpretive text of FCC orders. *Arbitration Order* at 175-77.

Discussion

I. The Department's Legal Rationale Is Incorrect.

A. Courts and the FCC Have Not Applied the Department's Rationale to FCC Regulations and the Interpretive Text in FCC Orders.

The rule of statutory construction that requires the existence of an ambiguity in the statutory language before resort may be made to legislative history or other interpretive text simply is not a feature of FCC jurisprudence. The courts, including the United States Supreme Court, and the FCC itself typically read the regulations together with the interpretive text in FCC orders to determine the meaning and effect of FCC rules.

This can be seen in the following examples from the Supreme Court, a Court of Appeals, and the FCC.

1. U.S. Supreme Court

In *Verizon V. FCC,* 535 U.S. 467 (2002), the Supreme Court upheld the FCC's rules regarding UNE combinations by reading those rules together with the interpretive text in the Local Competition Order, which accompanied the rules when first promulgated. The parties challenging the rules contended that the rules' requirement that ILECs must combine elements so long as "technically feasible"[1] unreasonably allowed CLECs virtually unlimited ability to request combination of network elements and imposed virtually unlimited obligations upon ILECs to provide such combinations. *Id.* at 536.

The Supreme Court rejected this contention, because the text in the Local Competition Order imposed meaningful limits upon the scope of "technical feasibility" in the context of UNE combinations.

> [T]he incumbents are wrong to claim that the restriction to "technical feasibility" places only minimal limits on the duty to combine, since the First Report and Order makes it clear that what is "technically feasible" does not mean merely what is "economically reasonable," *id.,* ¶ 199, or what is simply practical or possible in an engineering sense, see *id.,* ¶¶ 196-198. The limitation is meant to preserve "network reliability and security," *id.,* ¶ 296, n. 622, and a combination is not technically feasible if it impedes an incumbent carrier's ability

[1] Rules 315(c) and (d) provide:

> (c) Upon request, an incumbent LEC shall perform the functions necessary to combine unbundled network elements in any manner, even if those elements are not ordinarily combined in the incumbent LEC's network, provided that such combination is:
>
> (1) technically feasible; and
>
> (2) would not impair the ability of other carriers to obtain access to unbundled network elements or to interconnect with the incumbent LEC's network.
>
> (d) Upon request, an incumbent LEC shall perform the functions necessary to combine unbundled network elements with elements possessed by the requesting telecommunications carrier in any technically feasible manner.

47 C.F.R. § 51.315(c)-(d).

> "to retain responsibility for the management, control, and performance of its own network," *id.,* ¶ 203.
>
> This demanding sense of "technical feasibility," as a condition protecting the incumbent's ability to control the performance of its own network, is in accord with what we said in *Iowa Utilities Bd.* There, for example, we reinstated the Commission's "pick and choose" rule in part because the duty to provide network elements on matching terms to all comers did not arise when it was "not technically feasible," § 51.809(b)(2). 525 U.S. at 396, 119 S.Ct. at 721. If "technically feasible" meant what is merely possible, it would have been no limitation at all.

535 U.S. at 536 (footnote omitted).

Thus, despite apparently unambiguous language in the rules requiring ILECs to provide all "technically feasible" combinations, the Supreme Court read into the rules various limitations and interpretations set forth in the accompanying Local Competition Order. Notably, the Supreme Court did not find any ambiguity in the language of the regulations before resorting to the interpretive text of the Order. Nor did the Supreme Court indicate that it was necessary to find such ambiguity before consulting the Order. Instead, the Court read the regulations and accompanying interpretive text together as a harmonious whole.

2. Court of Appeals

In *SBC v. FCC,* No. 03-4311 (3rd Cir. July 14, 2005) (copy attached), the Third Circuit considered a challenge to an FCC interpretation of the circumstances under which a CLEC would be entitled to be tandem transit rate for terminating traffic. The court upheld the FCC's determination that a CLEC is entitled to be tandem transit rate if its switch serves a geographic area comparable to that of the ILEC switch, based on FCC rule 51.711(a)(3).[2] While the rule appears clear on its face that only a geographic test is required, the court was forced to reconcile an apparently inconsistent statement in the Local Competition First Report and Order suggesting

that the switch must also perform equivalent functions to the ILEC switch. Based on the statement in the First Report and Order, SBC argued that to be entitled to the tandem rate, the CLEC switch must satisfy both the geographic and the functional equivalency tests. *Id.,* slip op. at 25-26.

In its analysis, the court said, "As a general proposition, we agree that SBC's argument that the regulation must be read in conjunction with the Local Competition Order has merit." *Id.* at 28. The court, however, found that the FCC previously had stated in an order that a CLEC could use the functional equivalency rule to obtain the tandem transit rate when its switch did not serve a comparable geographic area to that of the ILEC. *Id.* at 29-31.

Two things are noteworthy. First, the FCC had previously pronounced that the functional equivalency test could be used to obtain tandem transit compensation, even though (i) the functional equivalency test appeared *only* in an FCC order and did not appear anywhere in the FCC's rules and (ii) the rules specified only the geographic test as the determining factor for obtaining the tandem transit rate. Obviously, the FCC did not think that its rules were the exclusive source of authority; the FCC clearly gave equal weight to the interpretive text of the Local Competition Order.

Second, the court upheld the FCC's determination. It found nothing amiss with the FCC's determination that the functional equivalency test could be used when the geographic test was not satisfied, even though the rule (setting forth only the geographic test) was unambiguous, and furthermore that the functional equivalency test was nowhere to be found in the FCC's promulgated regulations.

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[2] "Where the switch of a carrier other than an incumbent LEC serves a geographic area comparable to the area served by the incumbent LEC's tandem switch, the appropriate rate for the carrier other than an incumbent LEC is the incumbent LEC's tandem interconnection rate." 47 C.F.R. § 51.711(a)(3), quoted in *SBC v. FCC*, slip op. at 27.

3. FCC

The FCC does not draw the same distinction between its regulations and its orders as does the Department. The FCC has imposed extensive requirements outside the context of its formally promulgated regulations, by means of orders. It treats regulations and orders as having equivalent authority.

An important example began with the November 1999 *UNE Remand Order, In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* CC Docket No. 96-98, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, FCC 99-238 (Nov. 5, 1999). In that order, the FCC determined that requesting telecommunications carriers were permitted to use UNEs to provide exchange access services. It based its conclusion on the language of § 251(c)(3) of the Act (requiring ILECs to provide access to UNEs "for the provision of a telecommunications service") and upon a promulgated regulation, 47 C.F.R. § 51.309(a), which provides that "[a]n incumbent LEC shall not impose limitations, restrictions, or requirements on request for, or the use of, unbundled network elements that would impair the ability of a requesting telecommunications carrier to offer a telecommunications service in the manner the requesting telecommunications carrier intends." *Id.* ¶ 484. Further, based on §§ 51.309(a) and 51.315(b), the FCC said that

> to the extent those unbundled network elements are already combined as a special access circuit, the incumbent may not separate them under rule 51.315(b), which was reinstated by the Supreme Court. In such situations, it would be impermissible for an incumbent LEC to require that a requesting carrier provide a certain amount of local service over such facilities.

Id. ¶ 486.

Subsequently, however, to address concerns that interexchange carriers would convert special access circuits used for provision of access exchange services to loop-transport UNE

combinations on a large-scale basis, the FCC reversed itself and issued an order that substantially limited the ability of certain requesting carriers to obtain existing combinations. *In re Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* CC Docket No. 96-98, Supplemental Order, FCC 99-370 (Nov. 24, 1999) (*"Supplemental Order"*). In the *Supplemental Order,* the FCC prohibited IXCs from converting special access to loop-transport UNE combinations unless the CLEC uses loop-transport combinations to provide a significant amount of local exchange service, in addition to exchange access, to a particular customer. *Id.,* ¶ 2. Significantly, the FCC did not amend its regulations, even though the *Supplemental Order* directly and substantially limited an unambiguous FCC regulation.

Later, in June 2000, the FCC found it necessary to clarify the *Supplemental Order*. *In re Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* CC Docket No. 96-98, Supplemental Order Clarification, FCC 00-183 (June 2, 2000) ("*Supplemental Order Clarification"*). In the *Supplemental Order Clarification*, the FCC provided further detail as to what constituted a significant amount of local service such as would permit a special access circuit to be converted to a loop-transport combination, and provided a self-certification and audit mechanism to ensure compliance with the local service requirement. *Id.,* ¶ 1. Again, the FCC did not amend its regulations, but merely issued the order.

The FCC does not suggest that the *Supplemental Order* or *Supplemental Order Clarification* had any less force because they were orders rather than regulations. To the contrary, in the *WorldCom Arbitration Order*, the FCC referred to its "rules" regarding the then-existing prohibition against commingling.[3] "While the Commission's rules provide such a restriction with respect to EELs, this restriction does not apply generally with respect to all

[3] Commingling is combining loops or loops-transport combinations with tariffed special access services. *See Supplemental Order Clarification,* ¶ 28.

UNEs." *In the Matter of In the Matter of Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited Arbitration,* CC Docket No. 00-218, Memorandum Opinion and Order, DA 02-1731, ¶ 510 (July 17, 2002). The only authority that the FCC cited for this statement was the *Supplemental Clarification Order*. *Id.* ¶ 510, n. 1698. Yet, as noted above, that order was not a regulation, nor did it even accompany the promulgation of regulations. Clearly, then, the FCC considers the *Supplemental Clarification Order* to be a source of its "rules."

In another example, the FCC explicitly looked to "administrative history" to explain its regulations without having found ambiguity in those regulations. In arbitrating an open issue regarding whether CLECs could download the entire calling name (CNAM) database or merely query it, the FCC cited § 51.319(e)(2)(ii) of its regulations, which governs "switch and query" access to the database through physical access to the signaling transfer point linked to the database.[4] Without any finding — or, apparently, any contention by a party — that this provision was ambiguous, the FCC quoted from its Local Competition Order to explain what this provision meant:

> In adopting the original rules, the Commission stated that "[q]uery and response access to a call-related database," as provided for in rule 51.319(e)(2)(i), was "intended to require the incumbent LEC only to provide access to its call-related databases as is necessary to permit a competing provider's switch (including the use of unbundled switching) to access the call-related database functions supported by that database." This administrative history makes clear that the

[4] Rule 319(E)(2)(ii), as set forth in the Local Competition Order, provides:

> For purposes of switch query and database response through a signaling network, an incumbent LEC shall provide access to its call-related databases, including, but not limited to, the Line Information Database, Toll Free Calling database, downstream number portability databases, and Advanced Intelligent Network databases, by means of physical access at the signaling transfer point linked to the unbundled database.

> Commission did not intend, in the *Local Competition First Report and Order*, to enable competitive LECs to download or otherwise copy an incumbent's CNAM database.

WorldCom Arbitration Order, ¶ 525.

Thus, the FCC regularly looks to the text of its orders and considers them as much a part of its "rules" as the text of its formal regulations. The Department should be consistent and should not read the FCC's interpretive text out of existence. Instead, like the FCC, the Department should consider the text of the orders as controlling along with the regulations themselves.

B. The Case on Which the Department Relies is Inapposite.

In support of its view that it need not look beyond the text of the FCC's regulations unless those regulations are ambiguous, the department relies in the United States v. Lachman, 387 F.3d 42 (1st Cir.2004). *Arbitration Order* at 77. That case is inapposite.

In *Lachman,* a criminal defendant attempted to introduce the testimony of former administrative agency officials regarding the agency's internal practices in interpreting the regulations that the defendant was charged with violating. This is made clear by the context in which the quotation in the *Arbitration Order* (p. 77) appears. Immediately prior to the passage quoted in the *Arbitration Order*, the First Circuit said:

> The defendants now call our attention to post-trial affidavits that suggest [Department of] Commerce officials within the agency internally gave the term a contrary interpretation and affidavits as to statements made by Commerce officials at industry seminars also suggesting a contrary interpretation. These views of Commerce officials are simply irrelevant to our interpretive task.

387 F.3d at 54. The First Circuit also found fault with the proffered interpretations because they were not public. "In any event, agency interpretations are only relevant if they are reflected in public documents." *Id.*

Thus, in ruling that the district court could not consider the affidavits purporting to interpret the regulations that the defendants allegedly violated, the First Circuit determined:

> The non-public or informal understandings of agency officials concerning the meaning of a regulation are thus not relevant. The affidavits here of former and present agency officials as to the agency's non-public understanding of the regulation do not remotely satisfy the requirements of formality and public accessibility. The statements made by government officials at industry seminars (upon which the defendants also rely), although public, are also not the kind of formal agency statements that are entitled to deference.

Id. at 54-55.

This decision has nothing to do with the issues presented to the Department for arbitration. In *Lachman,* what the First Circuit found to be irrelevant were private or informal interpretations of agency regulations. Here, the FCC's limitation of the 10 DS1 cap to routes where DS3 unbundling was not required was not contained in the informal FCC practice or private interpretations. Instead, it was set forth in the text of the formal order issued along with the applicable regulations. Similarly, the FCC's confining FTTP and FTTC unbundling relief to loops serving mass-market customers also was contained in the text of formal FCC orders.

The holding of *Lachman,* that informal, unpublished statements concerning agency practices are not to be considered unless the regulations are ambiguous, simply does not apply here. The United States Supreme Court, at least one Court of Appeals, and the FCC itself all have put the interpretive texts containing FCC orders on an equal footing with the text of the FCC regulations. The Department should do the same.

II. The Department's Erroneous Interpretive Rationale Leads to Incorrect Results.

The Department's application of an erroneous interpretive rationale has led to incorrect and inappropriate results regarding the issues of the 10 DS1 cap and limitation of FTTH and FTTC unbundling relief to mass-market customers. In both cases, the results are inconsistent

with the FCC's rules (including interpretive text). Also, the Department's determinations disserve the policy goals of the Act and FCC rules.

A. Ten DS1 Cap.

In paragraph 128 of the *TRRO,* the FCC unambiguously wrote, "On routes for which we determine that there is no unbundling obligation for DS3 transport, but for which impairment exists for DS1 transport, we limit the number of DS1 transport circuits that each carrier may obtain on that route to 10 circuits." *TRRO* ¶ 128. The Department's erroneous interpretive rationale results in the Department's treating the first two clauses as if they were not there.

The Department should not assume that the FCC was merely wasting ink when it wrote the first two clauses. To the contrary, the Department should assume that the FCC included the first two clauses for a reason — that they were meant to apply. As the New York Public Service Commission determined, "We read the TRRO as a whole as intending to apply the 10-loop cap only where the FCC found non-impairment for DS3 transport. That is the most logical and reasonable interpretation of the FCC's action." *In re Ordinary Tariff Filing of Verizon New York Inc. to Comply with the FCC'S Triennial Review Order on Remand,* Case No. 05-C-0203, Order Implementing TRRO Changes, at 13 (Mar. 16, 2005).

The Department's determination also disserves the policy goals of the Act. The qualifying language derives from the nature and purpose of the impairment analysis — on routes where competitors are not impaired because they can self-provision DS3 transport or obtain it from non-ILEC providers, once they aggregate more than 10 DS1s of traffic, it becomes economical to self-provision a DS3 or obtain DS3 capacity elsewhere. "When a carrier aggregates sufficient traffic on DS1 facilities that it effectively could use a DS3 facility, we find that our DS3 impairment conclusions should apply." *TRRO* ¶ 128. By the same token, when

those "DS3 impairment conclusions" determine that there is impairment at the DS3 level, such that DS3s must be unbundled, then it makes no sense to limit the amount of DS1 unbundling to ten DS1s.

The Department's determination will reduce competitive choice for Massachusetts small businesses by limiting the ability of CLECs to provide service through EELs. Inappropriate restrictions on the number of DS1 transport circuits on a route will severely curtail CLECs' ability competitively to serve customers desiring DS1 service in the wire centers at the ends of that route. Via EELs, Conversent and other CLECs can serve those customers without the substantial time and expense of collocating in the wire center serving the customer's location. Customers' competitive choices thereby are increased, and consumer benefit enhanced. Ensuring availability of DS1 EELs may allow CLECs to provide broadband service in rural or remote wire centers where it would not be economical to deploy a full collocation arrangement.

B. Limiting FTTH and FTTC Unbundling Relief to the Mass Market.

The Department's erroneous refusal to limit the scope of unbundling relief for FTTH and FTTC loops to those loops service the mass market likewise ignores pages and pages of FCC interpretation. In the *Triennial Review Order*, *MDU Reconsideration Order*, *FTTC Reconsideration Order*, and *Triennial Review Remand Order*, the FCC has repeatedly stated that FTTH/FTTC unbundling relief applies to fiber loops serving mass market, residential customers. *See* Conversent's Initial Brief at 20-26.

The Department's determination also disserves the policy goals behind the FCC's decisions regarding FTTH and FTTC loops. *In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers,* CC Docket 01-338, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, FCC 03-36, ¶ 273

(Aug. 21, 2003) (*"Triennial Review Order"* or *"TRO"*). The FCC's decision to relieve ILECs of the obligation to unbundle FTTH loops was based in substantial part on the desire to promote broadband infrastructure investment under § 706 of the Act. *Id.* ¶ *236.* In its analysis, the FCC repeatedly referred to mass market, residential customers, and based its unbundling analysis on the costs and revenue potential associated with serving residential mass-market customers. The FCC specifically explained that its consideration of § 706 was in the context of promoting broadband deployment to the mass market:

> Through its "at a minimum" language, section 251(d)(2) provides the Commission with the discretion to consider factors in addition to impairment before requiring unbundling. We find that this discretion is appropriately exercised by evaluating whether unbundling of local loops used to provide broadband services to the mass market is consistent with our section 706 mandate.

Id. ¶ 242. The FCC further explained that the policy underlying its decision to grant FTTH unbundling relief was that "removing incumbent LEC unbundling obligations on FTTH loops will promote their deployment of the network infrastructure necessary to provide broadband service to the mass market." *Id.* ¶ 278.

The FCC repeated this policy rationale when it expanded the FTTH exemption to loops serving primarily residential multiple dwelling units (MDUs), holding that "to the extent fiber loops serve MDUs that are primarily residential in nature, those loops should be governed by the FTTH rules." *In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers,* CC Docket 01-338, Order on Reconsideration, FCC 04-191, ¶ 4 (Aug. 9, 2004) (*"MDU Reconsideration Order"*). In so doing, the FCC explained:

> [W]e conclude that the record here demonstrates that the same unbundling relief as provided for FTTH loops is warranted for such MDUs. In arriving at this conclusion, we are persuaded that making such a change in our rules is necessary to ensure that regulatory disincentives for broadband deployment are removed for carriers seeking to serve those customers – *residential customers* – that pose the greatest investment risk.

Id. ¶ 5 (emphasis added). Again, the FCC emphasized that the policy reason for granting unbundling relief was to promote broadband for the mass market.

Again, when the FCC expanded the exemption still further to FTTC loops, it emphasized the policy goal of removing disincentives for broadband infrastructure investment to serve the mass market. The FCC said:

> In the *Triennial Review Order*, the Commission limited the unbundling obligations imposed on mass-market FTTH deployments to remove disincentives to the deployment of advanced telecommunications facilities in the mass market. We find here that those policy considerations are furthered by extending the same regulatory treatment to incumbent LECs' mass-market FTTC deployments. Similarly, just as we found no impairment with respect to mass market FTTH loops in the *Triennial Review Order*, we also find that the level playing field for incumbents and competitors seeking to deploy FTTC loops, and increased revenue opportunities associated with those deployments, demonstrates that requesting carriers are not impaired without access to mass market FTTC loops.

In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, CC Docket 01-338, Order on Reconsideration, FCC 04-248, ¶ 2 (Oct. 18, 2004) (footnotes omitted) (*"FTTC Reconsideration Order"*).

It is important to note, however, that the FCC emphasized that its policy justification for relieving FTTH loops from the unbundling requirement was narrow.

> We engage in a balancing test in determining our unbundling requirements for mass market local loops. We recognize, of course, that impairment remains our statutory touchstone. We do not rely exclusively, however, on an impairment analysis to make our unbundling determination. We retain the flexibility under our section 251(d)(2) "at a minimum" authority to consider other factors. *We use this flexibility sparingly.* However, we believe that the goal of swift and ubiquitous broadband deployment is so important to the United States that we consider the statutory goals outlined in section 706 and how they relate to broadband as additional factors when considering loops.

TRO ¶ 234 (emphasis added). The FCC continued to emphasize the narrowness of the policy rationale in its repeated references to unbundling relief for the mass market in the *TRO, MDU*

Reconsideration Order, FTTC Reconsideration Order, and the *TRRO*. *See* Conversent's Initial Brief at 20-26.

The Department's decision regarding the scope of the FTTH/FTTC loop unbundling relief is overly broad. As a result, it disserves the policy aims that the FCC enunciated when it granted unbundling relief for FTTH and FTTC loops. The FCC applied the § 706 considerations "sparingly" (*TRO* ¶ 234) for purposes of promoting broadband deployment to the residential mass market. The FCC did not find that such special consideration was needed to spur broadband investment for customers other than the residential mass market. By its overbroad application of the FTTH/FTTC unbundling exception, the Department will diminish competition in the small to medium sized business market. The Department should reconsider its decision and confine the FTTH/FTTC exemption, as the FCC did, to mass market, residential customers.

Conclusion

For the reasons stated above, the Department should promote competition and the interests of the small businesses that Conversent primarily serves by reconsidering and revising its determinations as described above.

August 23, 2005

Respectfully Submitted,

Gregory M Kennan

Scott Sawyer
Gregory M. Kennan
Conversent Communications of
Massachusetts, Inc.
24 Albion Road, Suite 230
Lincoln, RI 02865
401-834-3326 Tel.
401-834-3350 Fax
gkennan@conversent.com

PRECEDENTIAL

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No: 03-4311

SBC INC.,
Petitioner

v.

FEDERAL COMMUNICATIONS COMMISSION;
UNITED STATES OF AMERICA,
Respondents

Petition for Review of an Order of the
Federal Communications Commission

Argued: November 16, 2004

Before: McKEE and CHERTOFF,[*] *Circuit Judges*,
and BUCKWALTER, *Senior District Judge*[**]

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[*]Judge Chertoff heard oral argument in this case but resigned before the opinion was filed. The opinion is filed by a quorum of the panel. 28 U.S.C. §§ 46(d).

[**]The Hon. Ronald L. Buckwalter, Senior District Judge of the United States District Court for the Eastern District of

(Opinion filed: July 14, 2005)

JAMES D. ELLIS, ESQ.
PAUL K. MANCINI, ESQ.
SBC Communications, Inc.
175 East Houston Street
San Antonio, Texas 78205

GARY L. PHILLIPS, ESQ.
JAMES P. LAMOUREUX, ESQ.
SBC Communications, Inc.
1401 I Street, N.W., 4th Floor
Washington, D.C. 20005

MICHAEL K. KELLOGG, ESQ.
COLIN S. STRETCH, ESQ. (Argued)
Kellogg, Huber, Hansen, Todd & Evans, P.L.L.C.
1615 M Street, N.W. Suite 400
Washington, D.C. 20036
Attorneys for Petitioner

R. HEWITT PATE, ESQ.
Assistant Attorney General
MAKAM DELRAHIM, ESQ.
Deputy Assistant Attorney General
ROBERT B. NICHOLSON, ESQ.
ROBERT B. WIGGERS, ESQ.
Attorneys

Pennsylvania, sitting by designation.

United States Department of Justice
Washington, D.C. 20530

JOHN A. ROGOVIN, ESQ.
General Counsel
RICHARD K. WELCH, ESQ.
DANIEL M. ARMSTRONG, ESQ. (Argued)
Associate General Counsel
JOHN E. INGLE, ESQ.
Deputy Associate General Counsel
RODGER D. CITRON, ESQ.
Counsel
Federal Communications Commission
Washington, D.C. 20554
Attorneys for Respondent

OPINION

McKEE, *Circuit Judge*.

SBC Communications, Inc., petitions for review of an order of the Federal Communications Commission captioned, "*Cost-Based Terminating Compensation for CMRS Providers*, 18 FCC Rcd 18441, released on September 3, 2003 (the "*Order Under Review*"). SBC contends that the *Order Under Review* violated the Administrative Procedure Act by improperly revising an FCC rule without first affording notice and an opportunity for comment as required by the APA. SBC also argues that the *Order Under Review* cannot be upheld because it is arbitrary and capricious. For the reasons explained below,

we will deny the petition for review.

I. GENERAL BACKGROUND

The technological sea change that has occurred in the telecommunications industry has revolutionized the manner in which local telephone service is provided. It has also resulted in dramatic changes in federal and state regulations of the industry. Prior to the passage of the Telecommunications Act of 1996 (the "1996 Act"), Pub. L. 104-104, 110 Stat. 56, "[s]tates typically granted an exclusive franchise in each local service area to a local exchange carrier ("LEC")." *AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366, 371 (1999). The LEC typically owned, "among other things, the local loops (wires connecting telephones to switches), the switches (equipment directing calls to their destinations), and the transport trunks (wires carrying calls between switches) that constitute a local exchange network."[1] *Id.* The 1996 Act restructured local telephone markets by preempting state and local franchise

[1] The jargon used in the telecommunications industry can be confusing because everyday words are used in a highly technical manner. For example, although the instant dispute involves the "switches" used in telecommunications, those switches bear no resemblance to the single pole, single throw, toggle switch that most of us use to turn lights on and off in our homes. Rather, these "switches" are computers that direct the flow of telephone traffic by controlling the electric circuits that conduct the electro magnetic energy that telephone calls consist of. *See Indiana Bell v. McCarty*, 362 F.3d 378 (7th Cir. 2004).

arrangements, 47 U.S.C. § 253, and by requiring "incumbent local exchange carriers (ILECs) to share their networks and services with competitors seeking entry into the local service market." *MCI Telecommunication Corp. v. Bell Atlantic-Pennsylvania*, 271 F.3d 491, 498 (3d Cir. 2001).

> Congress recognized that without allowing new entrants to use the incumbents' local exchange networks and other technology and services, the incumbents would maintain a stranglehold on local telephone service: no new entrant could realistically afford to build from the ground up the massive communications grid the incumbents had developed through years of monopolistic advantage.

Indiana Bell v. McCarty, 362 F.3d 378, 382 (7th Cir., 2004) (footnote omitted).

Among other things, the 1996 Act required that ILECs allow competitors to "interconnect" to their networks. *See* 47 U.S.C. § 251(c)(2). Interconnection is critically important to a competitive local exchange market. Without it, customers of one carrier – e.g., the ILEC, that has historically served that area – would not be able to call customers of another carrier – e.g., a competitive LEC ("CLEC"), that has recently initiated service in that same area.

When local carriers establish interconnection arrangements, the 1996 Act requires them to include compensation terms, known as "reciprocal compensation

arrangements," for delivery of the traffic they exchange. 47 U.S.C. § 251(b)(5). When a customer of carrier A makes a local call to a customer of carrier B, and carrier B uses its facilities to connect, or "terminate," that call to its own customer, the "originating" carrier A is ordinarily required to compensate the "terminating" carrier B for the use of carrier B's facilities. *See Global NAPS, Inc. v. FCC*, 247 F.3d 252, 254 (D.C. Cir. 2001) (Reciprocal compensation arrangement "means that when a customer of Carrier X calls a customer of Carrier Y who is within the same local calling area, Carrier X pays Carrier Y for completing or 'terminating' the call."). With respect to the compensation a carrier may recover for the transport and termination of traffic that originates with another carrier, the 1996 Act requires just and reasonable rates that provide for "the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier." 47 U.S.C. § 252(d)(2)(A)(I). The 1996 Act effectively defines a reasonable rate as one that is "a reasonable approximation of the additional cost of terminating such calls," and prohibits any regulatory proceeding to establish such costs "with particularity." 47 U.S.C. §§ 252(d)(2)(A)(ii), 252(d)(2)(B)(ii).

The 1996 Act directs competing LECs to address "reciprocal compensation" terms in the first instance through voluntary negotiations. *See* 47 U.S.C. §§ 251(b)(5), 252(a); *MCI Telecommunications*, 271 F.3d at 500. When they are unable to do so, the 1996 Act permits either party to petition the appropriate state utilities commission to arbitrate the dispute in accordance with the terms of the 1996 Act and the FCC's

implementing regulations. *See* 47 U.S.C. § 252(b)(1). The 1996 Act also required the FCC to adopt regulations to implement the Act, including its reciprocal compensation provisions. *See generally Iowa Utilities Board*, 525 U.S. at 377-78, 384. Within six months of the adoption of the 1996 Act, the FCC issued a comprehensive rulemaking decision to satisfy that requirement. *See* First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499 (1996) (the "*Local Competition Order*").[2]

In the *Local Competition Order*, the FCC established a presumption that the reciprocal compensation rates that two interconnecting carriers may charge each other are symmetrical.

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[2]Many parties petitioned for review of numerous aspects of the *Local Competition Order*. Those petitions were consolidated in the Eighth Circuit. The Order's subsequent history is as follows: *Modified on recon.*, 11 FCC Rcd 13042 (1996), *vacated in part, Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997), *aff'd in part, rev'd in part*, *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366 (1999), *decision on remand, Iowa Utils. Bd. v. FCC*, 219 F.3d 744 (8th Cir. 2000), *aff'd in part, rev'd in part*, *Verizon Communications Inc. v. FCC*, 535 U.S. 467 (2002). However, no party petitioned for review of the FCC's rule for determining the availability of the tandem interconnection rate for interconnecting carriers. That rule is the subject of this petition for review, and will be explained in more detail below.

Accordingly, the ILECs' rates generally serve as the proxy for other telecommunications carriers' additional costs of transport and termination. *Local Competition Order*, 11 FCC Rcd at 16031-44 (¶¶ 1069-1093); *see also* 47 C.F.R. § 51.71(a) (symmetrical reciprocal compensation rules). The FCC adopted symmetric rates because, among other things, they are easy to administer, can prevent ILECs' from taking advantage of their "unequal bargaining position," and do not discourage carriers' incentives to reduce costs. 11 FCC rcd at 16040-41 (¶¶ 1086, 1087, 1088); *see also Id.* at 16040 (¶ 1086). The FCC explained that it adopted the ILECs' rates as a proxy for the rates of other carriers because "[b]oth the incumbent LEC and the interconnecting carriers will be providing service in the same geographic area, so the[ir] forward-looking economic costs should be similar in most areas." *Local Competition Order*, 11 FCC Rcd at 16040 (para. 1085). This ratemaking scheme thus allows carriers to recover, through reciprocal compensation, "a reasonable approximation" of their costs. *See* 47 U.S.C. § 252(d)(2)(A)(ii).

The older, established telephone networks that traditionally have been built by ILECs utilize a hub-and-spoke design. The outside of the network – the ends of the spoke – are switches,[3] known as "end-office" switches, that directly serve customers in a particular local calling area. These end-office switches may be connected directly, one to another. In

[3] As noted above, a switch is a computer that directs the path of a telephone call by opening and closing the electrical pathway (or circuit) over which the call travels. *Supra* at n. 1.

addition (or alternatively), the end-office switches are connected to a "tandem" switch – the hub of the wheel. These tandem switches do not directly serve customers, but instead route calls to the appropriate end-office switch (sometimes via another tandem switch) and, therefore, serve a number of local calling areas. *See MCI Telecommunications*, 271 F.3d at 502. When a call goes through the ILEC's tandem switch, the ILEC incurs additional costs because it then has to transport the call from the tandem switch to the end-office switch. *Local Competition Order*, 11 FCC Rcd at 16042 (¶ 1090). *See also Indiana Bell Tel. Co. Inc. v. McCarty*, 362 F.3d at 384. Moreover, interconnecting carriers do not always have identical networks and therefore must sometimes terminate calls over different types of facilities.

The FCC recognized that "[n]ew entrants cannot hope to replicate the incumbents' network switch for switch" and would instead deploy "new technology" to terminate calls on their network. *Local Competition Order*, 11 FCC Rcd at 16042 (¶ 1090). Nevertheless, the FCC's *Local Competition Order* adopted a general regime of symmetrical reciprocal compensation rates and directed the states to establish "presumptive symmetrical rates based on the incumbent LEC's costs for transport and termination of traffic. . . ." 11 FCC Rcd at 16042 (¶ 1089). Given the advantages it perceived from using symmetrical rates, the FCC found that the ILECs' costs "serve as reasonable proxies for other carriers' costs of transportation and termination for the purpose of reciprocal compensation." *Id*. at 16041 (¶ 1088).

The FCC separately addressed the special situation that

occurs when a competing carrier's newer technology does not precisely replicate the traditional "tandem switch" routing typically employed by the ILEC. The FCC offered the following explanation of its resolution of that problem:

> We find that the "additional costs" incurred by a LEC when transporting and terminating a call on a competing carrier's network are likely to vary depending on whether tandem switching is involved. We, therefore, concluded that states may establish transport and termination rates in the arbitration process that vary according to whether the traffic is routed through a tandem switch or directly to the end-office switch. In such event, states shall also consider whether new technologies (e.g., fiber ring or wireless networks) perform functions similar to those performed by an incumbent LEC's tandem switch and thus, whether some or all calls terminating on the new entrant's network should be priced the same as the sum of transport and termination via the incumbent LEC's tandem switch. Where the interconnecting carrier's switch serves a geographic area comparable to that served by the incumbent LEC's tandem switch, the appropriate proxy for the interconnecting carrier's additional costs is the LEC tandem interconnection rate.

11 FCC Rcd at 16042 (¶ 1090).

The FCC thus mandated an inquiry into the geographic

area served in determining the appropriate compensation rate in some circumstances that may involve tandem switching even though the state of the competing carrier's technology might not use tandem switching to complete a given call.

The substance of this rule is set forth in the final sentence of ¶ 1090 of the *Local Competition Order*. That text is nearly identical to the text of Rule 51.711 (a)(3). Pursuant to ¶ 1090 and Rule 51.711(a)(3), a non-ILEC carrier is entitled to recover the tandem interconnection rate for terminating traffic on its network upon a showing that its switch serves a geographical area comparable to that served by the ILEC's tandem switch. According to the FCC, there is no need for the non-ILEC to also show that its switch is "functionally equivalent" to the ILEC's tandem switch.

The FCC claims that the initial reciprocal compensation rules inadvertently encouraged some competitive carriers to "game the system" by such practices as soliciting business only from internet service providers ("ISPs"). *See generally WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C.Cir. 2002), *cert. denied sub nom. Core Communications, Inc v. FCC*, 538 U.S. 1012 (2003). An ISP's dial-up customers call the ISP to connect to the internet and typically remain on the line for an extended period of time. When the ISP subscribes to a CLEC for its local service and the ISP's dial-up customers are local telephone customers of an ILEC, the CLEC's transport and termination services are used to connect the caller to the internet. However, the exaggerated duration of the connected calls meant that the CLEC recorded protracted use for purposes of reciprocal compensation calculations. As the Court of

Appeals for the D.C. Circuit recently found, the FCC's initial reciprocal compensation regime was "flaw[ed]" because "ISPs typically generate large volumes of one-way traffic in their direction." *WorldCom, Inc. v. FCC*, 288 F.3d at 431. According to the FCC, some competitive carriers were able to earn substantial parts of their revenues by delivering traffic that originated on the ILEC network to the ISPs on the competitive carriers' own networks. CLECs would therefore receive compensation for completing lengthy calls made by an ILEC's customers yet never have to pay an ILEC for completing traffic in the other direction. This system attracted some competitive LECs "that entered the business simply to serve ISPs, making enough money from reciprocal compensation to pay their ISP customers for the privilege of completing the calls." *Id.*

According to the FCC, this practice by some CLECs was partly responsible for causing some state utility commissioners to try to reduce what they perceived as excessive payments to competitive carriers that were solely in the business of terminating calls to ISPs. *See Intercarrier Compensation Regime*, 16 FCC Rcd at 9649 n.173. In arbitration proceedings before state utility commissions after the *Local Competition Order* became effective, some state commissioners interpreted ¶ 1090 of the *Local Competition Order* as imposing upon a non-ILEC carrier two separate conditions precedent to recovering the tandem interconnection rate. *Id.* Such a carrier would have to establish *both* that its switch served a geographic area comparable to the ILEC's, *and* that its switch functioned in a manner equivalent to the ILEC's tandem switch. *See, e.g.,* Arbitration Award*, Proceeding to Examine Reciprocal Compensation Pursuant to Section 252 of the Federal*

Telecommunications Act of 1996, Docket No. 21982, 2000 Tex. PUC Lexis 95 (Tex. PUC July 13, 2003) at *45-47; *see also* Opinion and Order Concerning Reciprocal Compensation*, Proceeding on Motion of the Commissioner to Reexamine Reciprocal Compensation*, N. Y. PUC LEXIS 398 at *96-97 (N.Y. PSC Aug. 26 1999).

This two prong test resulted in some CLECs receiving the lower non-tandem rate for reciprocal compensation and thus receiving smaller amounts of compensation. According to the FCC, some federal district courts affirmed some of those state commission decisions. FCC's Br. at 11 (citing, e.g., *U. S. West Communications, Inc. v. Public Serv. Comm'n*, 75 F.Supp.2d 1284, 1289 (D.Utah 1999)).

In addition to these specific rules regarding the tandem interconnection rate, the FCC also adopted two more general rules relating to reciprocal compensation rates. First, the FCC adopted a rule that mirrored the "additional costs" language of § 252(d)(2)(A)(ii) requiring that reciprocal compensation rates be "structured consistently with the manner that carriers incur th[e] costs" of terminating local calls. 47 C.F.R. § 51.709(a); *see also id.* § 51.507(a) (requiring rates to be "structured consistently within the manner in which the costs of providing the elements are incurred"). Second, the FCC stressed that reciprocal compensation rates must be crafted consistently with "rate structure rules" that require distinct rates for different functions, including (I) "tandem switching," (2) "local switching," and (iii) the use of "transmission facilities between tandem switches and end offices." *Id.* §§ 51.509, 51.709(a).

II. THE CURRENT DISPUTE.

On February 2, 2000, Sprint PCS wrote a letter to the chiefs of the FCC's Common Carrier Bureau (now known as the "Wireline Competition Bureau") and Wireless Telecommunications Bureau seeking guidance on whether a wireless telephone service provider may "recover in reciprocal compensation all the additional costs it incurs in terminating local traffic originated on other networks." *See* Letter from Jonathan M. Chambers, Sprint PCS, January 26, 2000. The letter was prompted by state commissioner decisions on reciprocal compensation that Sprint PCS claimed were inconsistent with the 1996 Act and the Local Competition Order. *Id.* at 18, 19-20.

The FCC issued a public notice requesting comments on the Sprint letter, and numerous parties responded. *Attwood Letter*, 16 FCC Rcd at 9598. Many of the responses also asked the FCC to clarify the rule governing payment of the tandem interconnection rate for terminating traffic to commercial mobile radio service providers ("CMRS" or "wireless" or "mobile carriers"). *See, e.g.*, Comments of Western Wireless Corporation, June 1, 2000 (App. 48-49); *see also* Reply Comments of US West Communications, Inc., June 13, 2000 (App. 62).

On April 27, 2001, while Sprint's letter request was pending, the FCC released a *Notice of Proposed Rulemaking* ("NPRM"), in which it undertook to reexamine the general subject of intercarrier compensation. *See Intercarrier Compensation NPRM*, 16 FCC Rcd 9610. The NPRM

addressed many subjects, including the question of when an interconnecting carrier is entitled to recover the tandem rate for reciprocal compensation.

The FCC acknowledged that there had been some disagreement over the availability of the tandem interconnection rate – specifically, whether a competitive carrier must demonstrate functional equivalency as a separate requirement independent of, and in addition to, comparable geographic area coverage in order to recover the tandem rate. *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9647, 9648 (¶¶ 103, 105). The FCC noted that "in dealing with problems presented by ISP-bound traffic, some states have incorporated a functional equivalency test into their interpretations of section 51.711(a)(3)." *Id.* at 9649 n.173. For example, both "the Texas PUC and the New York PCS concluded that large imbalances in traffic flows strongly suggest that a carrier is serving a higher proportion of convergent customers rather than a large distribution of customers similar to those served by an ILEC tandem switch." *Id*.

The FCC stated that the state commission decisions imposing a separate functional equivalency requirement in addition to the geographic area test were "inconsistent with our rule." *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9649 n.173. The Commission pointed out that Rule 51.711(a)(3) requires only that a carrier demonstrate that its switch serve "a geographic area comparable to that served by the incumbent LEC's tandem switch" in order to receive the tandem rate. *Id.* at 9648 (¶ 105). Nevertheless, the FCC acknowledged the problems addressed in those state decisions and it undertook to

"consider whether to amend the rule to give states greater flexibility in applying a tandem interconnection rate to networks using newer, more efficient technologies." *Id.* at 9649 n.173. It also invited comment, including comment on whether it should amend its rule to include "the 'functional equivalency' concept. . . ." *Id.* at 9649 (¶ 107).[4]

On May 9, 2001, the chiefs of the Common Carrier Bureau and the Wireless Telecommunications Bureau, acting on delegated authority, released the *Attwood Letter* addressing the issues raised in Sprint's letter as well as the responsive comments. 16 FCC Rcd 9597. The *Attwood Letter* was an opinion letter of the FCC staff. Although it primarily addressed Sprint's inquiry regarding wireless carriers' incurring asymmetrical, "additional costs" in terminating telephone traffic, it also addressed "when a carrier is entitled to the tandem interconnection rate." *Id.* at 9599. The *Letter* noted that the FCC had recently confirmed that, "[w]ith respect to when a carrier is entitled to the tandem interconnection rate, . . . section 51.711(a)(3) requires only a geographic area test." *Id*.[5] The opinion *Letter* concluded: "Therefore, a carrier demonstrating that its switch serves a 'geographic area comparable to that served by the incumbent LEC's tandem switch' is entitled to the tandem interconnection rate to terminate local

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[4] The issues raised in the FCC's NPRM have not yet been resolved.

[5] The FCC had confirmed this in the *Intercarrier Compensation NPRM.*

telecommunications traffic on its network." *Id*.

SBC then sought review of the *Attwood Letter* by the full Commission. SBC argued that in eliminating the "functional equivalence" test, the *Attwood Letter* allowed a CLEC that meets the geographic comparability test to charge for both tandem switching and transmission to the end-office switch, even if it did not perform those functions. SBC was concerned that, absent an inquiry into functional equivalence to ensure that the switching in question was tantamount to tandem switching, originating carriers may pay the higher tandem switching rate even though the terminating carrier never had to provide that service to terminate calls on its network.

In applying for review of the *Attwood Letter*, SBC alleged that the FCC staff had engaged in legislative rule-making without complying with the procedural notice and comment requirements of the APA. SBC also argued that the *Attwood Letter* was contrary to the language of the 1996 Act and the Commission's rules and orders. *See* Application for Review of SBC Communications, Inc., June 8, 2001 (App. 65, 74-80).

The Commission denied both claims in the *Order Under Review*. The *Order Under Review* affirmed the reasoning of the FCC staff in the *Attwood Letter*. The full Commission thus concluded that the clarification of the applicable rule – as announced in the *Intercarrier Compensation NPRM* and the *Attwood Letter* – was an interpretive ruling not subject to the notice and comment requirements of the APA. *Order Under Review* at ¶¶ 22-25. The FCC also concluded that the plain

language of the relevant statutory provisions governing reciprocal compensation only required satisfaction of the geographic area test. *Id.* at ¶¶ 17-21. Thereafter, SBC filed the instant petition for review.[6]

III. STANDARD OF REVIEW

Here, as before the Commission, SBC argues that the

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[6] We have jurisdiction pursuant to 28 U.S.C. § 2342(1), which provides"

> The court of appeals (other than the United States Court of Appeals for the Federal Circuit) has exclusive jurisdiction to enjoin, set aside, suspend (in whole or in part), or to determine the validity of –
> (1) all final orders of the Federal Communications Commission made reviewable by section 402(a) of title 47;

and 47 U.S.C. § 402(a), which provides:

> Any proceeding to enjoin, set aside, annul, or suspend any order of the Commission under this chapter (except those appealable under subsection (b) of this section) shall be brought as provided by and in the manner prescribed in chapter 158 of Title 28.

FCC's elimination of the functional equivalency test in determining appropriate compensation between carriers violated the APA because it was tantamount to legislative rule-making and therefore subject to the APA's requirement of notice and comment. If we conclude that the agency acted "without observance of procedure as required by law," 5 U.S.C. § 706(2)(D), we must vacate the *Order Under Review* and remand the issues raised in the *Attwood Letter* back to the FCC so that the agency can comply with the notice and comment requirements of the APA. *See Sprint Corp. v. FCC*, 315 F.3d 369, 377 (D.C. Cir. 2003). However, an agency's determination that "its order is interpretative," and therefore not subject to notice and comment requirements, "in itself is entitled to a significant degree of deference." *Viacom International Inc. v. FCC*, 672 F.3d 1034, 1042 (2d Cir. 1982) (citation and internal quotations omitted).

In reviewing the substance of SBC's claim that the *Attwood Letter* is inconsistent with the 1996 Act, we must uphold the *Order Under Review* unless it is "arbitrary, capricious, [an] abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). This is a "deferential standard" that "presume[s] the validity of agency action." *Southwestern Bell Tel. Co. v. FCC*, 168 F.3d 1344, 1352 (D.C.Cir. 1999). The FCC is due substantial deference in its implementation of the Communications Act, and "even greater deference" when interpreting its own rules and regulations." *Capital Network Sys. v. FCC*, 28 F.3d 201, 206 (D.C.Cir. 1994). *Global NAPs, Inc. v. FCC*, 247 F.3d 252, 257-58 (D.C.Cir. 2001).

IV. DISCUSSION

Given the apparent complexity of the subject matter, and the resulting potential for confusion, it will be helpful to restate the substance of SBC's challenge to the *Order Under Review* and place it in context before discussing the merits of the parties' positions.

To reiterate, when a customer of carrier A makes a local call to a customer of carrier B, carrier B must use its facilities to connect (or "terminate") that call to its customer. Under the Act, carrier A (the "originating" carrier) is required to compensate carrier B (the "terminating" carrier) for using carrier B's facilities to connect the call to carrier B's customer.

SBC is an ILEC. As we also explained earlier when discussing the hub-and-spoke design that typifies "traditional" telephone networks, when a call goes through SBC's tandem switch, SBC incurs additional costs because it has to transport the call from the tandem switch to the end-office switch. More specifically, SBC must (I) switch the call at the tandem switch, (ii) transport the call to the end-office switch that serves the CLEC's customer, and then (iii) switch the call at the end-office switch and deliver it to that customer. Under the 1996 Act, SBC can recover the costs of each of those functions from the CLEC. The costs are grouped together into a single rate known as the "tandem interconnection rate," or "tandem rate," and that is the rate that the CLEC must pay SBC for using SBC's network to complete calls to the CLEC's customer.

However, the same is not true when a local customer of

SBC calls a CLEC's customer because the CLEC will frequently have the advantage of more efficient and sophisticated technology that was not available when SBC built its network. Accordingly, the CLEC may not duplicate SBC's end-office switch and tandem switch network in terminating traffic. According to SBC, the CLEC's new technology will not involve the three distinct functions to connect an incoming call. SBC claims that the CLEC's compensation for completing the call should therefore reflect the CLEC's reduced costs. SBC submits that the functional equivalency test better captures that actual cost than the geographic area test because the equivalency inquiry allows the greater efficiency of more modern technology to be factored into the equation. According to SBC, the geographic area test ignores any differences between its network and the CLEC's network by only focusing on the area served by competing carriers. As noted above, SBC makes two arguments to support its position, and we consider each claim separately.

A. The *Order Under Review* Violates the Notice and Comment Requirements of the Administrative Procedure Act.

> In the *Attwood Letter*, the FCC's staff stated:
> With respect to when a carrier is entitled to the tandem interconnection rate, the Commission stated that section 51.711(a)(3) of its rules requires only that the comparable geographic area test be met before a carrier is entitled to the tandem interconnection rate for local call termination. It noted that although there has been

> some confusion stemming from additional language in the text of the *Local Competition Order* regarding functional equivalency, section 51.711(a)(3) requires only a geographic area test. Therefore, a carrier demonstrating that its switch serves "a geographic area comparable to that served by the incumbent LEC's tandem switch" is entitled to the tandem interconnection rate to terminate local telecommunications traffic on its network. The *NPRM* does seek comment on whether we should change this rule.

16 FCC Rcd 9597. In affirming that interpretation, the FCC explained:

> We find that the [*Attwood Letter*'s] interpretation of our rules is correct. Section 51.711(a)(3) of our rules governs when the tandem rate is applicable, and plainly requires *only* a comparable geographic area test to be met for a carrier to receive the tandem interconnection rate: "Where the switch of a carrier other than an incumbent LEC *serves a geographic area comparable to the area served by the incumbent LEC's tandem switch*, the appropriate rate for the carrier other than an incumbent LEC is the incumbent LEC's tandem interconnection rate."

Order Under Review, at 8 (quoting 47 C.F.R. § 51.711(a)(3)) (emphasis in original).

SBC claims that the FCC announced the functional equivalency test in its *Local Competition Order*, and that the *Order Under Review* effectuated a substantive change in the law without adhering to the notice and comment requirements of the APA. Therefore, SBC contends the *Order Under Review* is unlawful and must be vacated.

"It is a maxim of administrative law that: 'If a second rule repudiates or is irreconcilable with a prior legislative rule, the second rule must be an amendment of the first rule; and, of course, an amendment to a legislative rule must itself be legislative.'" *National Family Planning and Reproductive Health Ass'n, Inc. v. Sullivan*, 979 F.2d 227, 235 (D.C. Cir. 1992) (citation and internal brackets omitted). "'Legislative' rules that impose new duties upon the regulated party have the force and effect of law and must be promulgated in accordance with the proper procedures under the Administrative Procedure Act." *Chao v. Rothermel*, 327 F.3d 223, 227 (3d Cir. 2003) (citation omitted). The applicable provision of the APA provides, in relevant part:

> (b) General notice of proposed rule making shall be published in the Federal Register, unless persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. . . .
>
> (c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or

> arguments with or without opportunity for oral presentation.

5 U.S.C. § 553(b), (c).

Legislative rules are subject to the notice and comment requirements of the APA because they "work substantive changes in prior regulations," *Sprint Corp*., 315 F.3d at 374, or "create new law, rights, or duties." *Fertilizer Institute v. EPA*, 935 F.2d 1303, 1307-08 (D.C. Cir. 1991). "'Interpretative' rules, on the other hand, seek only to interpret language already in properly issued regulations." *Chao*, 327 F.3d at 227 (citation omitted). "If the agency is not adding or amending language to the regulation, the rules are interpretative." *Id.* (citation omitted). "Interpretative, or 'procedural,' rules do not themselves shift the rights or interests of the parties, although they may change the way in which the parties present themselves to the agency." *Id*. (citation omitted). "An interpretative rule simply states what the administrative agency thinks the statute means, and only reminds affected parties of existing duties." *Fertilizer Institute*, 935 F.2d at 1307 (citation and internal quotations omitted). "Interpretative or procedural rules and statements of policy are exempted from the notice and comment requirement of the APA." *Chao*, 327 F.3d at 227 (citing 5 U.S.C. § 553(b)(A)).

Thus, one of the questions that must be answered in determining whether an agency rule is legislative or interpretative is "whether the rule effectively amends a prior legislative rule." *American Mining Congress v. Mine Safety & Health Administration*, 995 F.2d 1106, 1112 (D.C. Cir. 1993).

Furthermore, if an agency's present interpretation of a regulation is a fundamental modification of a previous interpretation, the modification can only be made in accordance with the notice and comment requirements of the APA. *Paralyzed Veterans of America v. D.C. Arena, L.P.*, 117 F.3d 579, 586 (D.C. Cir. 1997).

SBC insists that the *Order Under Review* eliminated the functional equivalency test, and that it therefore changed the FCC's prior interpretation of a CLEC's entitlement to the tandem rate. Accordingly, argues SBC, it was tantamount to a legislative amendment and subject to the APA's requirement of notice and comment. According to SBC, the legislative amendment results from the focus of the *Order Under Review* on the language of Rule 51.711(a)(3).

As noted, that rule states that a CLEC is entitled to the tandem rate where the CLEC's switch "serves a geographic area comparable to the area served by the incumbent LEC's tandem switch." According to SBC, the *Order Under Review* therefore had the effect of completely eliminating the functional equivalency inquiry mandated by the *Local Competition Order.* SBC claims that worked a substantive change in the FCC's prior pronouncements regarding a CLEC's entitlement to the tandem rate without invoking the notice and comment provisions of the APA. *See Paralyzed Veterans of America,* 117 F.3d at 586 ("Once an agency gives its regulation an interpretation, it can only change that interpretation as it would formally modify the regulation itself: through the process of notice and comment rulemaking.").

SBC's claim is not without some force as there is language in the *Local Competition Order* that appears to support SBC's claim. The *Local Competition Order* provides, in relevant part:

> the "additional costs" incurred by a LEC when transporting and terminating a call on a competing carrier's network are likely to vary depending on whether tandem switching is involved. *We, therefore, concluded that states may establish transport and termination rates in the arbitration process that vary according to whether the traffic is routed through a tandem switch or directly to the end-office switch. In such event, states shall also consider whether new technologies (e.g., fiber ring or wireless networks) perform functions similar to those performed by an incumbent LEC's tandem switch and thus, whether some or all calls terminating on the new entrant's network should be priced the same as the sum of transport and termination via the incumbent LEC's tandem switch.* Where the interconnecting carrier's switch serves a geographic area comparable to that served by the incumbent LEC's tandem switch, the appropriate proxy for the interconnecting carrier's additional costs is the LEC tandem interconnection rate.

11 FCC Rcd at 16042 (¶ 1090) (emphasis added).

Moreover, the FCC concedes that some state

commissions have interpreted this portion of the *Local Competition Order* as establishing a two-part test for determining a CLEC's entitlement to the tandem rate. Those commissions have concluded that a CLEC seeking the tandem rate must establish *both* that its switch served a geographic area comparable to the ILEC's tandem switch *and* that its own switch performed functions equivalent to the functions performed by the ILEC's tandem switch. However, the FCC notes that the only *regulation* it actually adopted for purposes of determining when a CLEC is entitled to the tandem rate (after discussing the issue in the *Local Implementation Order*) was Rule 51.711(a)(3), which provides:

> Where the switch of a carrier other than an incumbent LEC serves a geographic area comparable to the area served by the incumbent LEC's tandem switch, the appropriate rate for the carrier other than an incumbent LEC is the incumbent LEC's tandem interconnection rate.

47 C.F.R. § 51.711(a)(3). The FCC correctly emphasizes that that regulation says nothing about requiring the "other carrier" (the CLEC) to also satisfy a functional equivalency test to qualify for compensation at the LEC's tandem interconnection rate.

Nevertheless, SBC insists that the regulation cannot be read in isolation from the *Local Competition Order,* and there is support for that position. In *Verizon Communications Inc. v. FCC*, 535 U.S. 467, 537-38 (2002), the Supreme Court upheld an FCC rule on the basis of a limitation expressed not in the

rule itself, but rather in the text of the *Local Competition Order*.[7] Moreover, SBC contends that the rule's omission of a functional equivalency requirement does not resolve the inquiry because the discussion of functional equivalence in the *Local Competition Order* can not be ignored.

As a general proposition, we agree that SBC's argument that the regulation must be read in conjunction with the *Local Competition Order* has merit. We cannot accept SBC's position here, however, without ignoring FCC pronouncements before it issued the *Order Under Review* on September 3, 2003. For example, in the *Intercarrier Compensation NPRM*, released on April 27, 2001, the FCC did note that some states had applied a functional equivalency test to determine the availability of the tandem rate. *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9646-49 (¶¶ 102-107 & n.173). However, the FCC then clearly stated in the NPRM that such state interpretations were "inconsistent with our rule." *Id.* at n.173. Significantly, the FCC issued the NPRM partly to "seek comment on whether

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[7]The *Local Competition Order* at issue here is the First Report and Order. The FCC has issued subsequent Reports and Orders also referred to as the *Local Competition Order*. For example, the Second Report and Order can be found at 11 FCC Rcd 19392 (1966) and the Third Report and Order can be found at 15 FCC Rcd 3696 (1999). Each Report and Order was mentioned by the Supreme Court in *Verizon Communications*; however, the Court's ruling mentioned in the text of this opinion was based on the First Report and Order, which is the *Local Competition Order* involved here.

section 51.711(a)(3) should be *amended* to include the 'functional equivalency' concept discussed in the text of the Local Competition Order." *Id.* at 9649 (¶ 107) (emphasis added). Obviously, if the FCC believed that § 51.711(a)(3) contained a functional equivalency requirement when promulgated, no amendment would have been necessary.

Moreover, the *Order Under Review* specifically addressed SBC's contention that the regulation must be read in conjunction with the *Local Competition Order*. The *Order Under Review* reads, in relevant part, as follows:

> SBC also argues that section 51.711(a)(3) of our rules must be interpreted to require both a functional equivalence test and a comparable geographic area test based on the discussion in the *Local Competition Order* addressing this issue. As the [*Attwood Letter*] correctly noted, however, the Commission has previously addressed the import of this language in the [NPRM] and stated that "although there has been some confusion stemming from additional language in the text of the [*Local Competition Order*] regarding functional equivalency, section 51.711(a)(3) is clear in requiring only a geographic area test." We reaffirm this interpretation.

Order, at 9, ¶ 21 (footnotes omitted). In a footnote to the second sentence, the FCC further clarified what it was referring to in the *Local Competition Order* when it discussed functional equivalence:

> In reaffirming the Commission's interpretation of the tandem interconnection rate rule, we find no inconsistency between the discussion in the *Local Competition Order* . . . and the language in the promulgated rule. The *Local Competition Order* does refer to a functional analysis that states should apply, but then imposes a geographic area test as a sufficient condition for receiving the tandem rate. *The comparable geographic area test acts as a special case of the functional analysis, i.e, if the geographic area test is satisfied, then functional similarity is established for purposes of determining the appropriate reciprocal compensation rate*. The Commission thus did not preclude states from finding that new technologies are functionally similar to tandem switches even though they do not serve a geographic area comparable to that served by the incumbent LEC's tandem switch. *See, e.g., Florida PSC Order*, 2002 WL 1576912 ("it is appropriate to consider the functionality of an CLEC's network in situations where it does not serve a geographic area comparable to that served by an ILEC tandem switch.").

Id. at 9 n.63 (emphasis added).

Accordingly, the *Order Under Review* clearly explained that the FCC decided that a CLEC's newer technology switch is considered the functional equivalent of an ILEC's tandem switch if the geographic area served by the CLEC's newer

switch is comparable to the area served by the ILEC's tandem switch. However, a functional equivalency test is still required when, and only when, the CLEC's newer technology switch does not serve a geographic area comparable to that served by the ILEC's tandem switch. Therefore, reading the *Local Competition Order* in conjunction with the regulation does not produce the result SBC advocates.

We conclude that the *Order Under Review* is thoroughly consistent with the *Local Competiton Order*, the regulation, and the *Intercarrier Compensation NPRM*. The *Order Under Review* did not modify or substantively change the FCC's prior interpretation of the regulation or impose new duties upon regulated parties, and therefore the APA's notice and comment requirements do not apply. The *Order Under Review* is, at most, interpretative. It simply clarified, and explained, an existing rule.[8] *Sprint Corp.*, 315 F.3d at 373.

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[8]This is not a case like *Caruso v. Blockbuster-Sony Music Entertainment Center*, 193 F.3d 730 (3d Cir. 1999) where an agency's subsequent interpretation of a rule would result in the adoption of an entirely new regulation without the notice and comment required by the APA. In *Caruso*, the agency's initial rule, which addressed the placement of wheelchair locations in facilities like the Blockbuster-Sony Music Center, did not include a requirement that wheelchair users be able to see over standing patrons. A subsequent interpretation of that rule that included such a requirement was relied on by a wheelchair bound plaintiff alleging a violation of the rule. However, we found that because the initial rule did not address the issue of

SBC also contends that the *Order Under Review* repudiated the decision in *U.S. West Communications v. MFS Intelenet, Inc.*, 193 F.3d 1112 (9th Cir. 1999). There, the court cited the *Local Competition Order* at ¶ 1090 in stating that "the Commission found that MFS's switch 'is comparable in geographic scope' to U.S. West's tandem switch and 'performs the function of aggregating the traffic . . .." 193 F.3d 1112. SBC relies upon that statement in arguing that the court interpreted FCC rulings as requiring a functional equivalence test as well as a geographic area test. SBC then argues that, since the *Order Under Review* substantively altered the legal landscape in the Ninth Circuit, it constituted a new rule and was therefore subject to the APA's notice and comment requirements.[9]

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sightlines over standing spectators, the subsequent interpretation of that rule to include such a requirement was really an adoption of a new regulation without notice and comment.

[9]In making this argument, SBC cites *National Mining Ass'n v. Department of Labor*, 292 F.3d 849 (D.C. Cir. 2002). SBC contends that *National Mining* stands for the proposition that where an agency's decision sustains one court's interpretation of a regulation, but reverses another court's interpretation of the same regulation, the agency's decision is a new rule that must meet the APA's notice and comment requirements. However, *National Mining* had nothing to do with the APA's notice and comment requirements. Instead, it addressed the question of the retroactivity of a new agency rule

The difficulty with this argument is that the court in *MFS Intelenet* did not hold that functional equivalency was a factor in determining compensation rates. Rather, there, the court was only considering whether "[t]he Commission's classification of MFS's switch as a tandem switch was . . . arbitrary and capricious." 193 F.3d at 1124. In holding that it was not, the court noted that the Commission "properly considered whether MFS's switch performs similar functions and serves a geographic area comparable to U.S. West's tandem switch." *Id*., at 1124 (citing *Local Competition Order* at ¶ 1090.). However, the court was not concerned with reciprocal compensation or calculating the appropriate rate a CLEC can charge for completing an ILEC's customer's calls over the CLEC's network. Accordingly, the court's inquiry into whether MFS's network relied upon tandem switches has nothing to do with whether functional equivalency is an element of the compensation rate at issue here.

Moreover, in a later case, the Court of Appeals for the Ninth Circuit clarified this by adopting the same interpretation of the tandem interconnection rate rule that the FCC approved in the *Order Under Review*. In *U.S. West Communications, Inc.*

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that essentially adopts the position taken on an issue by one court of appeals, but rejects the position taken by another court of appeals on the same issue. Nevertheless, we will, for argument's sake, accept SBC's claim that where there has been a substantive change in the law, the test for retroactivity is the same as an inquiry into whether notice and comment are required under the APA. Reply Br. at 12 n.5.

v. Washington Utilities and Transportation Commission, 255 F.3d 990 (9th Cir. 2001), the issue was whether AT & T Wireless (the CLEC) was entitled to reciprocal compensation based on U.S. West's (the ILEC) end-office rate or tandem rate. U.S. West argued that AT & T should receive reciprocal compensation at the less expensive end-office rate rather than the higher tandem rate because AT&T's mobile switches "[did] not provide the 'same services'" as U.S. West's tandem switch. *Id.* at 996. "AT & T argue[d] that, according to § 51.711(a)(3) . . . it is entitled to the tandem rate because its [mobile switching centers] serve a geographic area comparable to the area served by U.S. West's tandem switches." *Id*. Relying upon the regulation and the text of the *Local Competition Order*, the court concluded that, pursuant to § 51.711(a)(3), AT & T only needed to establish that it served a comparable geographic area to be entitled to the higher tandem compensation rate. *Id.* at 994-98. The court rejected U.S. West's argument to the contrary. *Id.* at 995-96. Accordingly, we can not agree that the *Order Under Review* substantively altered the legal landscape in the Ninth Circuit.

In its Reply Brief, SBC changes its tactic somewhat. There, it argues that the *Order Under Review* was subject to the notice and comment requirements of the APA because it removed the prior authority state commissions had been given to consider functional equivalence in arbitrating compensation agreements pursuant to the *Local Competition Order*. *See* Reply Br. at 10 to 12. SBC claims that "the FCC has no tenable response to the undisputed fact that numerous state commissions and federal courts interpreted the *Local Competition Order* to authorize an inquiry into functional equivalence." *Id*., at 10. In

its opening brief, the FCC had argued that "to [its] knowledge, no federal court of appeals has embraced the ILECs' argument that paragraph 1090 of the *Local Competition Order* imposes a separate functionality requirement in addition to the comparable geographic area test for a competitive carrier to recover the tandem interconnection rate." Appellee's Br. at 12 n.5. SBC then relies upon *MFS Intelenet* to support its attempt to refute the FCC's claim.

However, as we have already explained, the holding in *MFS Intelenet* does not support SBC's position in this dispute. Moreover, the fact that several state utilities commissions adopted a functional equivalence test in arbitrating compensation agreements can not change the text of the regulation that should have governed those arbitrations. That regulation only allows an inquiry into the equivalence of the ILEC's and CLEC's networks when the competing carriers do not serve comparable geographic areas. The fact that state commissions may have strayed beyond those parameters during the regulatory process does not mean that the FCC had to follow the notice and comment requirements of the APA before clarifying what had already been pronounced in the *Local Competition Order*.

B. The *Order Under Review Is Not Arbitrary or Capricious.*[10]

[10]As recited in the earlier discussion of the standard of review:

SBC also argues that even if the *Order Under Review* did not violate the notice and comment requirements of the APA, it is arbitrary and capricious because it ensures that a CLEC will receive the higher tandem interconnection rate for all the local traffic terminated over its networks, whether or not it has incurred the costs related to tandem switches. In SBC's view,

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> Under the APA, a reviewing court must uphold an FCC order unless it is found to be "arbitrary, capricious, and abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). This is a "deferential standard" that "presume[s] the validity of agency action." *Southwestern Bell Tel. Co. v. FCC*, 168 F.3d 1344, 1352 (D.C.Cir. 1999). The FCC is due substantial deference in its implementation of the Communications Act, and "even greater deference" when interpreting its own rules and regulations." *Capital Network Sys. v. FCC*, 28 F.3d 201, 206 (D.C.Cir. 1994).

Global NAPs, Inc. v. FCC, 247 F.3d 252, 257-58 (D.C.Cir. 2001).

that result is contrary to the language of the 1996 Act and the FCC's own regulations; it is therefore arbitrary and capricious. As explained below, we need not reach the merits of that argument because it is time-barred. However, even if SBC were not foreclosed from raising that argument, we would find that it is without merit.

(1). The Time-Bar.

In arguing that the *Order Under Review* is arbitrary and capricious in not including functional equivalence in the compensation equation, the SBC is actually attacking the reasonableness of Rule 51.711(a)(3) itself. However, 28 U.S.C. § 2344, provides that judicial review of a final order of the FCC must be filed within 60 days after its entry. Rule 51.711(a)(3) was promulgated and adopted in August 1996. Rather than seeking judicial review within that 60 day period, SBC attacked the substance of the Rule in its application for review of the *Attwood Letter* in June of 2001. However, the period within which it could seek the judicial review of Rule 51.711(a)(3) has long since passed and it cannot be challenged in this petition for review.

Not unexpectedly, SBC contends that its substantive challenge to the Rule is not foreclosed by 28 U.S.C. § 2344. It argues that it had no reason to seek review of the Rule in 1996 because the *Local Competition Order* allowed an inquiry into the functional equivalency of a CLEC's switching technology in determining the compensation rate. SBC contends that it was only after the *Attwood Letter* and the *Order Under Review* affirming that *Letter*, that it had reason to know of the demise

of the functional equivalency test. SBC believes, therefore, that it may challenge the substantive validity of the rule in a petition for review outside of the 60-day filing deadline.

SBC cites *RCA Global Communications, Inc. v. FCC*, 758 F.2d 722 (D.C. Cir. 1985) in support of its claim that its petition for review is timely. There, the court wrote:

> Although statutory time limitations on judicial review of agency actions are jurisdictional, self-evidently the calender does not run until the agency has decided a question in a manner that reasonably puts aggrieved parties on notice of the rule's content.

Id. at 730. Similarly, in *Northwest Tissue Ctr. v. Shalala*, 1 F.3d 522, 530 n.8 (7th Cir. 1993), the court explained:

> Before any litigant reasonably can be expected to present a petition for review of an agency rule, he first must be put on fair notice that the rule in question is applicable to him. Otherwise the agency could promulgate a confusing regulation and, after expiration of the time for any judicial contest, clarify it to the surprise and prejudice of a party whose opportunity for judicial review meanwhile has been extinguished.

However, we can not accept SBC's position without ignoring the fact that the text of Rule 51.711(a)(3) only required functional equivalency in determining if a CLEC is allowed the

tandem rate when the CLEC and ILEC do not serve a comparable geographic area. Absent that limitation, the rule simply does not contain an additional requirement of functional equivalency. Accordingly, SBC was on notice about the proper application of the rule when it was initially promulgated. Yet, it sought review long after the 60 day period for doing so had expired. Therefore, SBC's belated attempt to now challenge the reasonableness of the Rule is barred by 28 U.S.C. § 2344.

(2). SBC's Claim Is Meritless Even If It Is Timely.

We would find SBC's claim that the *Order Under Review* is arbitrary and capricious meritless even if its claim was not time-barred. SBC maintains that the "tandem interconnection rate" consists of three discrete rate elements for each of three distinct functions – tandem switching, transmission between the tandem switch and the end-office switch, and end-office switching. SBC cites the *Local Competition Order* to support its contention that, under the 1996 Act, a CLEC is only entitled to the tandem rate to the extent that the CLEC performs the three functions that comprise that rate. The statute authorizes reciprocal compensation rates that compensate carriers for the "costs associated with the transport and termination . . . of calls that originate on the network facilities of the other carrier." 47 U.S.C. § 2552(d)(2)(A)(I). It also states that the only compensable costs are those that a carrier actually incurs in performing such "transport and termination." Finally, under the statute, reciprocal compensation rates are to be set "on the basis of a reasonable approximation of the additional costs of terminating such calls." 47 U.S.C. § 252 (d)(2)(A)(ii). SBC reminds us

that the FCC has explained that the statute thus contemplates that reciprocal compensation rates be cost-based, and that they "treat transport and termination as separate functions – each with its own cost." *Local Competition Order*, 11 FCC Rcd at 16106 (¶ 1040).

In SBC's view, however, the tandem rate rule, as interpreted in the *Order Under Review*, is not cost-based. Rather, that interpretation of the tandem rate rule entitles a CLEC to receive the entire tandem rate for all traffic delivered to its switch based only upon a showing that its switch serves a geographic area comparable to that served by the ILEC's switch. In SBC's view, that approach is over-inclusive for a number of reasons.

First, SBC claims that the FCC's staff has held that the geographic area test refers not to the actual area served by the CLEC's switch, but rather to the area that could be served by that switch. SBC's Br. at 27 & n.7 (citing autorities). In SBC's view, that is no test at all because modern switches, i.e., switches used by CLECs, are capable of serving wide geographic areas equivalent to 10 to 15 times the area ILEC tandem switches can cover. SBC argues that we can not uphold the *Order Under Review* because it allows a CLEC to receive the tandem rate for all the traffic it receives solely because it could in theory terminate some of that traffic over a broad area, divorced from any reasonable conception of actual cost.

Second, SBC contends that even if the test is confined to circumstances in which the CLEC actually serves a comparable

geographic area, it still remains over-inclusive because it would nevertheless permit a CLEC to receive the tandem rate on all the local traffic it receives at its switch, even where the traffic is switched only once and where the CLEC need not transmit it to a distant end-office switch. According to SBC, this allows the CLEC to receive the tandem rate on all the traffic it receives, even though it never performs two of the three functions (tandem switching and transmission to the end-office switch) encompassed by the tandem rate.

Moreover, SBC claims that this is no idle-possibility because, prior to the FCC's revision of its rules, several state commissions had ruled that a CLEC could not, consistent with the statute, receive the tandem rate on all of the traffic delivered to its switch when the bulk of that traffic was switched once and delivered to so-called convergent customers – i.e, customers located right next door to the CLEC's switch. SBC cites New York as an example of a state commission realizing that many new CLECs had targeted specific types of customers primarily for the purpose of generating large reciprocal compensation payments from the ILEC and refusing to permit the CLECs to receive the tandem compensation rate in all circumstances.[11] The state commissioner explained that the costs of serving a small number of large, convergent customers will likely be lower than the costs of serving a mass market. The

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[11] *See* Opinion and Order Concerning Reciprocal Compensation, *Proceeding on Motion of the Commmission to Reexamine Reciprocal Compensation*, Case 99-C-0529, N.Y. PUC LEXIS 398 (N.Y. PSC Aug. 26, 1999).

commissioner concluded that compensating CLECs that serve such customers at the tandem rate would overcompensate them and encourage them to target convergent customers not as a sustainable business strategy, but rather as a means of drawing above-cost revenues from ILECs.

SBC contends that the "convergent customer situation" highlights the anomalies inherent in always compensating a CLEC as though it is serving a geographically dispersed customer base through a network architecture similar to the ILEC's when it is in fact using a single switch and no transmission facilities to terminate traffic. However, SBC claims that the *Order Under Review* mandates that result.

SBC also claims the result reached in the *Order Under Review* is not just contrary to the cost-based approach mandated by the statute, but contrary to other FCC regulations as well. As an example, SBC cites to the rule requiring that, "[i]n state proceedings, a state commissioner shall establish rates for the transport and termination of telecommunications traffic that are *structured consistently with the manner that carriers incur those costs.*" 47 C.F.R. 51.709(a) (emphasis SBC's). According to SBC, where a CLEC uses only a single switch to terminate traffic to its customers, it does not incur the costs associated with the two levels of switching, much less the costs of transmitting the traffic from one switch to another. Therefore, in SBC's view, paying rates designed to cover such costs is simply a windfall to the CLEC that cannot be justified under the FCC's "cost-causative" approach to reciprocal compensation. *Local Competition Order*, 11 FCC Rcd at 16029 (¶ 1063). We are also told that the windfall violates FCC rules

requiring that rates for transport and termination be "structured . . . consistently with the principles in . . . [section] 51.509." 47 C.F.R. § 51.109(a). Rule 51.509 established "rate structure rules" contemplating different and discrete rates for (1) "tandem switching," (2) "local switching," and (3) the use of "shared transmission facilities between tandem switches and end offices." 47 C.F.R. § 51.509. However, according to SBC, the *Order Under Review* allows the CLEC to be compensated for all of these functions in all cases without regard for whether they were all performed, simply because the CLEC serves a geographic area comparable to the area served by the ILEC.

Finally, SBC notes that the FCC's rules generally require symmetrical reciprocal compensation rates. As we explained earlier, the "incumbent LEC's transport and termination prices [serve] as a presumptive proxy for other . . . carrier's additional costs of transport and termination." *Local Competition Order*, 11 FCC Rcd at 16040 (¶ 1085); *see also* 47 C.F.R. § 51.711(a). Yet, SBC claims that the *Order Under Review* is asymmetrical because it allows an ILEC to recover the tandem rate only when the CLEC elects to deliver traffic at the ILEC's tandem switch, and thus only when the ILEC actually performs each of the discrete functions (tandem switching, transmission to the end-office switch, and end-office switching) intended to be recovered in the tandem rate. Yet, CLECs are entitled to recover the entire rate, even when they do not perform those discrete functions.

For all of these reasons, SBC contends that the *Order Under Review* is arbitrary and capricious. We cannot agree.

SBC's arguments are based upon its interpretation of "costs" in § 252(d)(2)(A) isolated from the rest of the text. Section 252(d)(2)(A), authorizes reciprocal compensation rates based upon a "*reasonable approximation*" of costs. 47 U.S.C. § 252(d)(2)(A)(ii) (emphasis added). SBC's reading of the rule and regulation ignores the a crucial portion of the text. More importantly, in § 252(d)(2)(B)(ii), Congress specifically prohibited "any rate regulation proceeding to *establish with particularity* additional costs of transporting and terminating calls." *See* 47 U.S.C. § 2552(d)(2)(B)(ii) (emphasis added). It is therefore clear that Congress did not contemplate, and clearly did not require, a calculation of the "actual" costs of transporting and terminating calls. In fact, Congress precluded taking that approach to compensation between carriers.

The issue is therefore whether the FCC's rules governing reciprocal compensation establish rates that recover a "reasonable approximation" of the CLEC's costs. It is a basic principle of statutory construction that "a word is known by the company it keeps," and this rule of construction is "wisely applied where a word is capable of many meanings." *Jarecki v. G.D. Searle & Co.*, 367 U.S. 303, 307 (1961); *see also Deal v. United States*, 508 U.S. 129, 132 (1993) ("the meaning of a word cannot be determined in isolation, but must be drawn from the context in which it is used"); *Sekula v. FDIC*, 39 F.3d 448, 454 (3d Cir. 1994) ("[o]ne must look at the entire provision, rather than seize on one part in isolation").

With these canons as our compass, we note that § 252(d)(2)(A) does not define "costs" as "actual costs." Yet, SBC's submission is precisely that. It is arguing that "costs"

means "actual costs," even though proceedings to determine "actual costs" are prohibited by Congress. Congress's use of the term "costs" in the reciprocal compensation context indicates that it intended to avoid reciprocal compensation rates based on actual costs and complex cost studies. 47 U.S.C. § 252(d)(2)(B)(ii). Instead, Congress required that the rates for reciprocal compensation be based upon a "reasonable approximation of the additional costs of terminating" calls that originate on another carrier's network. 47 U.S.C. § 252(d)(2)(A)(I), (ii).

When all is said and done, SBC's understandable desire to see compensation it pays to CLECs be based upon a more precise calculus than the geographic area test can perhaps best be answered by a pronouncement the Supreme Court made in another context in *Verizon Communications Inc. v. FCC*, 535 U.S. 467, 539 (2002). There, in rejecting a claim that the price of leasing a competitor's network must be based on a precise evaluation of various economic factors and costs, the Court said:

> The 1996 Act sought to bring competition to local-exchange markets, in part by requiring incumbent local-exchange carriers to lease elements of their networks at rates that would attract new entrants when it would be more efficient to lease than to build or resell. Whether the FCC picked the best way to set these rates is the stuff of debate for economists and regulators versed in the technology of telecommunications and microeconomic pricing theory. The job of

> judges is to ask whether the Commission made choices reasonably within the pale of statutory possibility in deciding what and how items must be leased and the way to set rates for leasing them. The FCC's pricing and additional combination rules survive that scrutiny.

The FCC's compensation scheme for reciprocal rates also survives that scrutiny. The *Order Under Review* is thoroughly consistent with the *Local Competition Order* and the Rule 51.711(a)(3), and we will therefore deny SBC's petition for review.[12]

IV. CONCLUSION

For all of the above reasons, we will deny SBC's petition for review of the FCC's *Order Under Review* dated September 3, 2003.

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[12]As an aside, and without suggesting anything about the merits of SBC's concerns, we agree with the FCC that SBC should present the argument it is making in this petition for review to the FCC in proceedings under the NPRM. There, the FCC has invited comment on whether to revise § 51.711(a)(3) to include a functional equivalency test.